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TAGS: ECON EFIN EIND PREL SOCI JM
SUBJECT: JAMAICA: ECONOMIC GROWTH EXCEEDS EXPECTATIONS,
BUT FUNDAMENTALS REMAIN WEAK

REF: A.) KINGSTON 1286

B.) KINGSTON 1559

Summary

¶1. Jamaica's economy is estimated to have grown by 2.8 percent between April and June 2006 -- twice the rate projected by the Planning Institute of Jamaica (PIOJ), and this despite a shock to the construction sector from a recent cement crisis (ref. A). Growth has been largely the result of tourism and, to a lesser extent, recovery in agricultural production. Other areas of the macro-economy also registered improved performance during the review quarter, with inflation slowing to 2.8 percent amidst declining interest rates and relative stability in the foreign exchange market. Because of improved revenues, the country's fiscal position also exceeded expectations. GDP growth is expected to continue on the back of robust tourism, agriculture, and mining. Despite continuing increases in the costs of energy, housing, food, and drink, the rate of inflation should remain below last year's. This, combined with expected foreign exchange market stability because of record foreign exchange inflows, should allow the central bank to reduce interest rates in the second half of 2006. However, this is not necessarily an indication that the economy is on the upswing: formidable challenges loom, particularly in the form of debt. End summary.

GDP Exceeds Target

¶2. Data released by the Planning Institute of Jamaica (PIOJ) on August 17 show that economic growth is estimated to have increased by 2.8 percent during the June quarter, surpassing the 1.4 percent target. Services went up by 3.4 percent, reflecting robust tourism performance, while goods production increased by 1.1 percent as a result of strong recovery in agriculture. Tourism continues to be the mainstay of the Jamaican economy, contributing half of the GDP growth (1.4 percent) registered during the review period. Stopover arrivals, influenced by increased advertising, record flights, expanded room capacity and the re-introduction of "Reggae Sunsplash", surged by 24.1 percent during the quarter. Cruise arrivals, aided by the introduction of bigger ships, also climbed by 13.8 percent. Agriculture, which has been battered by both excessive rain and prolonged drought in previous quarters, grew by 17 percent during the quarter. This recovery was the result of favorable weather conditions during the period.

¶3. GDP could have grown by almost four percent were it not for the supply side constraints presented by the cement crisis (ref. A), which slowed the fast-growing construction sector (and to a lesser extent the manufacturing sector). Construction, which had been growing by up to 10 percent before the crisis, dropped by 3.5 percent, while manufacturing declined by 1.4 percent. (Comment: This brings into focus one of the underlying problems facing the Jamaican economy: the inability to achieve a confluence of factors required to propel growth. Therefore, while growth exceeded expectations it was still: (1) outpaced by the growth in the stock of debt; (2) below the level required to improve the debt dynamics; and, (3) lower than the average for countries at Jamaica's level of development. End comment.)

Other Macroeconomic Indicators Also Improve

¶4. Government finances for 2006 improved because of strong revenues and lower-than-projected capital spending. For the first quarter of the Jamaican fiscal year (April-June 2006), central government operations generated a deficit of USD 115 million, USD 49 million better than projected (ref. B). There was also a moderation in inflation to 2.8 percent, lower than the 5.6 percent recorded during the corresponding period of 2005. Inflation, during the review period, was fuelled by rising energy and food prices. The central bank was able to respond to demand pressure in the foreign exchange market by periodically selling funds from its stock of NIR. As a consequence, the currency depreciated by only 0.6 percent, while the stock of NIR ended the quarter at a healthy USD 2.1 billion.

...But Challenges Remain

¶5. In upcoming quarters, however, the GOJ will have a difficult time meeting revenue targets, given the anticipated normalization in tax revenues. Expenditures are also expected to gain momentum, as capital projects pick up pace and general elections approach. Even more disconcerting, however, is the rising stock of debt required to finance expenditures. Most of this debt will have to be raised on the domestic market due to rising international interest rates. In addition to affecting the timing and magnitude of expected domestic interest rate declines, the growing debt also will continue to cause a drag on the very economic growth required to generate the revenues needed to improve the debt dynamics (reducing the debt stock and the debt-to-GDP ratio). Inflation, while moderating relative to 2005, has been inching up each month due to rising oil, food and drink, and utility prices. The relative foreign exchange market stability has also been underpinned more by intervention from the stock of NIR, which is costly, rather than from robust inflows of foreign exchange.

Outlook

¶6. GDP could expand in July to September, as cement supplies return to normal. In fact, the PIOJ is projecting GDP growth of 2.7 percent. This target is not over-optimistic, since tourism and mining are already up 19 percent and 10.4 percent, respectively, in July. Construction and manufacturing have also bottomed out and are poised to rebound in the July-September quarter. However, the disputatious industrial climate and the cooling U.S. economy, which will affect tourism, could impact growth in upcoming quarters. Fiscal performance is also expected to wane in upcoming quarters unless the GOJ can broaden the tax base or divest assets. Nevertheless, there could be some positives in the financial markets with interest rates expected to decline given the continued liquidity in the domestic market. The extent of the rate decline will depend on the GOJ's appetite for debt, foreign exchange inflows

and the movement in domestic inflation and international interest rates.
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